Thrift and the Financial Situation

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WHAT is the financial situation of the United States? More particularly, what does our financial situation disclose that makes the practice of thrift and saving a matter of very great national urgency at the present time? The great outstanding facts in a summary view of our financial situation, which are pertinent to this inquiry, are:

1. The prodigious scale of our public expenditures;
2. The unprecedented weight of our direct tax levies;
3. The excessive volume of our governmental borrowing.

Extraordinary expenditures occasioned by the war thus far amount to over thirty billions of dollars with the prospect that the figure will be raised to thirty-five billions by the end of the current fiscal year. Direct tax levies on individual incomes and the earnings of industry are running at the rate of about six billion dollars a year. The money borrowed by the Treasury to finance the public requirements, since the beginning of the war, amounts to twenty-five billions of dollars.

These are stupendous figures. Events and conditions since the armistice are beginning to bring home to many of us for the first time the economic meaning to the nation and to the life of the average citizen of the financial situation thus developed by the war and left after its close.

Magnitude of War Expenditures

Levy on Capital Accumulations

Expenditures of the magnitude of those incurred by the United States for the war unquestionably mean some considerable impairment of the rate of the nation's capital accumulations during the past two and one-half years. No country is rich enough to stand such a drain upon its economic resources as the United States has been subjected to during this period without suffering an appreciable impairment of its capital account. The extent to which the huge expenditures of the government have cut into the capital accumulations of the country can not be determined, but common observation and complaint bear evidence that it constitutes a very important item in the economic cost of the war. The circumstance that, during the war the whole thought and energy of the nation was concentrated on the problem of increasing production facilities for the production of war supplies, resulted in less that the normal provision being made for the upkeep and extension of such of the country's industrial equipment as was not primarily needed in war-time, however important it might be in peace-time.

Deferred Capital Replacements

The run-down condition of the transportation system of the country, particularly the street-car service, and the great shortage of dwelling house

accommodations are striking examples coming within the experience of most people of the way in which the war and the insistent and voracious demand it made for first call upon the productive capacity and resources of the country, interrupted the up-keep of many of the productive facilities of the country not clearly essential to the prosecution of the war. There are many other evidences here, there and elsewhere throughout the country, of the fact that the war has left the capital equipment of the nation—that is, buildings, tools, machinery, etc.—in many important fields of industry in such a condition that much must be done to bring it up to a normal state of adequacy and efficiency. More buildings, more machinery, more trackage, etc. must be built. These things are a part of the industrial equipment of the community—they are its capital. On them depends the productivity of American industry and American labor. Impairment in the rate of growth of capital means impairment of our industrial capacity. The productivity of American industry and labor depends, more than can be said of any other community in the world, upon the character and the extent of the industrial equipment with which they are provided. Our rapid industrial progress in the past, it has long been recognized, was due largely to the fact that abundant provision was always made out of the product of industry for its further extension and development and improvement.

Before the war about one-sixth of our productive power, as nearly as can be estimated, was devoted annually to the improvement and extension of the industrial equipment and plant facilities of the country, to the development and exploitation of its natural resources, to the building of roads and houses, and to many other things, which added much every year to the capital resources and productive capabilities of the country. In brief, before the war about one-sixth of the wealth, which we annually produced, was saved and practically all accrued to the nation's industrial- and financial-capital account.

During the war much, if not most, of our customary industrial expansion was suspended, despite the fact that there was a notable increase in the individual savings of the American people. All of the new savings and most of the normal savings during the period of the war were absorbed by the government and were used directly or indirectly in furtherance of war production. No doubt much of the new industrial equipment called forth by war production will, also, be found useful for peace-time production and, to that extent, will not be lost altogether to the capital account of the country. Nevertheless, most of the savings appropriated for public use in the time of our war emergency represent something which, from the point of view of the nation's peace-time economy, must be regarded as unproductive expenditure and economic waste. There is, therefore, a shortage in the capital equipment of the country due to the diversion of the bulk of the country's savings during the war from the production of peace-time facilities to war-time facilities, which must somehow or other be made good if American industry is to maintain its normal productivity. There is but one known economic method by which this result can be accomplished and that is the method of saving.

CAPITAL REPLACEMENTS MADE THROUGH SAVING

How is saving related to the all-important matter of restoring and improving and increasing the industrial equipment or capital of the country?

To most people saving is thought of as laying aside money, or as giving up something which has customarily been consumed or which might be consumed. This is, however, merely the first step of the saving process, as a brief illustration will disclose. Perhaps I am on the point of buying an automobile. Heeding the injunction to save, I decide to give up my purchase of an automobile, at any rate for the present, and until the present national and world emergency is measurably over. What does my action in foregoing the purchase and use of an automobile do to help industry? Specifically, how does it result in an addition to the industrial capital of the country and thus help to make industry more productive? So far as I can trace my action all that I save is the dollars which the automobile would have cost and which the gasoline, tires and other requisities for the operation of the automobile would have cost. What do my saved dollars do to improve the economic situation—to repair or build factories and otherwise expand production facilities? I can see what my saved dollars do to give me dollars against the contingencies of a rainy day sometime in the future by assuring me of something in the bank with which to buy food and clothing, but I have still to be shown how my refraining now, for example from the purchase of an automobile, increases the productivity of industry, makes goods more abundant, and thus helps to bring down prices and improve the financial situation generally.

When you save dollars, Mr. Reader, you save what dollars will buy. In the case in question, your going without an automobile either saves that automobile for some more important use than your pleasure or, what is more likely, supposing that others are doing as you are doing, it saves industry the necessity of devoting as much labor and material and machinery to the production of automobiles as would otherwise be necessary and thus releases that labor and material and machinery for something else, which, in the existing circumstances of the country and the world, is more necessary. In brief, when you save money by cutting down your current consumption, you save more than dollars and you save more than the goods that you go without. You save the labor that it costs to produce those goods and you liberate the labor and productive power thus saved for the production of other things—such as, machinery, buildings and other much needed requisites of production—which it is most urgent the country and the world should have more of at the present time.

DIRECT TAXES AND CAPITAL ACCUMULATION

Diversion of Capital from Channels of Industry.—The need of a great increase in individual savings, in order to provide the requisite capital for expansion of our industries, gets much additional emphasis from the circumstance that a large part of the tax revenues, now being collected by the government under the new methods and the high levels of taxation which were developed with the war, are undoubtedly eating into the current savings and, therefore, the current capital accumulations of a very important

section of the nation's saving class. The tax revenues, which it is estimated will be collected by the government for the fiscal year 1920, aggregate six and a half billions of dollars. The great bulk of this revenue comes from surtaxes on the higher grades of income and from excess profits taxes on business. Large incomes and the earnings of business are, also, the source from which has hitherto come a principal, if not the principal, part of the savings of the country and the new capital, which from year to year became available for the use of industry.

Receivers of large incomes for the most part do not spend all their income for current consumption but invest a considerable proportion, probably the greatest portion, in industrial undertakings. The stream of saved income that flowed from this source into industry, supplying it with new capital, now flows, to a large extent, into the public treasury, supplying it with the means of meeting its current disbursements. The current expenditures of the government are not to any appreciable extent to be regarded as economic expenditures. It is only indirectly, as the income of the government is used in liquidating war contracts, etc., and thus flows back into the channels of business, that any considerable portion of it will be saved and accrue to the capital account of the country.

While it is impossible to estimate the extent to which the diminution in the flow of savings from the incomes of those who bear the main burden of high taxation is thus offset, it does not seem likely to be sufficient to invalidate the proposition that the extremely high direct taxes, which are being levied by the government of the United States, are eating into the current capital accumulations of the country to a degree that is considerable. The effects will be serious unless the loss thus arising is made good by increased saving on the part of all those in the community whose ability to save has not been impaired as a result of the financial situation occasioned by war. This means, to put the matter briefly, that the increased savings of the many must make up for the diminished savings of the few, so long as the financial needs of the government, or other conditions, or considerations of social policy, make it necessary to keep direct taxes at their present high levels.

Affect of Taxes on Production.—Questions of direct taxation are commonly regarded only from the points of view of fiscal expendiency and distributive justice. In ordinary circumstances these points of view may suffice, but in the present extraordinary circumstances of our country and the whole world, a more fundamental point of view must be taken. With the capital account of all the leading countries of the Western World seriously depleted, as a consequence of the great war, and with the burden of direct taxation reaching a point never before thought possible, the effects of taxation upon the productive economy of the several countries must be given thoughtful study. The war and every experience, which has followed since the armistice, has taught us to think in terms of production. A considerable section of the population of Europe —the most highly organized part of the world—is and has been in a state of want with destitution and, in some parts, starvation threatening, because of insufficient production. Production, more production, more efficient production, is an urgent need of the world

in the throes of this, the most severe after-war crisis ever experienced.

Saving and Production.—In these circumstances fiscal and financial questions must be looked at from the point of view of national economic interest, as well as from the point of view of social justice. Looking at the scale of our present direct taxation from the economic point of view, it does not admit of question that the rate of growth of capital in the United States will be seriously affected unless, to repeat the statement, the savings of the many make up for the decrease in the savings of the few. Dependent as the growth of industry and production is upon the stream of capital with which it is fed, saving is the urgent need of the hour. Saving is producing. More of us must make our dollars produce. Things, which are now scarce and dear because production is inadequate, will then become more abundant and prices fall.

Saving and the Price Level.—But saving will do more than this to improve the financial situation. Saving will not only bring down prices by increasing the production and supply of goods but will bring down prices by reducing the supply of money. The most troublesome feature of our financial situation is the high and rising level of prices. Recent events are showing that high and rising prices present more than a financial difficulty. They are the cause of our acute cost of living problem and the industrial unrest and general unsettlement of mind and the financial instability which invariably attend great price disturbances. Reasonable stability of value in the monetary standard is necessary to a good state of mind in a highly organized industrial community. Instability inevitably breeds unrest and unsettlement.

Until the upward movement of prices is arrested and the dollar begins to recover its lost value, we may expect to have an unsatisfactory and troublesome financial situation with the evil economic and social consequences, which such a situation invariably entails. To correct the existing financial and price situation is, therefore, tantamount to taking the most important step toward the correction of our current social and industrial unrest. People are everywhere uneasy and apprehensive because of the declining value of the dollar. To restore the dollar to something more nearly approaching its normal value and to reduce prices may, therefore, be said to be the most important financial problem before the country.

Factors Controlling Price Level.—That there is no way of handling the problem that does not involve the practice of thrift and saving by all sections and classes of the country upon an intensive scale becomes clear on examination of the financial factors that have helped to bring prices to their present levels.

Increased Currency and Underproduction.—Speaking in broad terms, changes in prices proceed from changes in the relation of the volume of purchasing media (what, in common speech, is called money) to the volume of goods offered for sale. When people, generally, have more money in their pockets, or more credit at their banks, with which to buy, than there are goods on the shelves of shopkeepers, which can be bought, goods get dear and money gets cheap. In other words, when there is more money seeking to buy goods than there are

goods seeking to buy money, prices rise and their rise will go on as long as the increase in the supply of purchasing media or money proceeds at a faster rate than the increase in the supply of purchasable goods.

Governmental Borrowing

That excessive supply of credit and currency has been one of the principal influences in putting up and keeping up prices in the United States is incontestable. That excessive borrowing by the government has been the main occasion of the excessive increase in the volume of purchasing media seems pretty clear, if, by *excessive* borrowing be understood, not borrowing in excess of what the government has required to defray its expenditures, but borrowing in excess of the current savings of the country.

Extent of Government Borrowing.—The Treasury of the United States has borrowed, during the past two years and a half, over $25,000,000,000. Of this amount about $21,500,000,000 have been borrowed by the issue of bonds. The remaining three and a half billions have been borrowed by the issue of short-dated certificates of indebtedness. Twenty-five billions in the course of two years and a half is an extraordinary amount of money to raise, even for a country as rich as the United States. It averages about $1,250 for every American family. It is an average of $500 per year for each such family. That such an amount could be taken out of the average income of the American people, except as they greatly reduced consumption and greatly increased savings, needs no demonstration.

Extent of Loans from Savings.—People of moderate means who did their full duty in subscribing to the loans of the government by actually cutting down their current expenditures and paying for their bonds in dollars actually saved out of their incomes know from their own experience that there is no method by which such vast loans can be taken up and paid for except by the practice of severe economy. It was because all of the people did not practice economy to the requisite degree that the savings of the country were not adequate to take up the securities issued by the Treasury as genuine "savings loans." To the extent that the borrowings of the government were in excess of what were paid for by savings, the loans became "credit loans" and, as such, resulted in a great increase in the volume of the country's circulating credit and its currency.

Expansion of Banking Credit.—The following table shows for selected dates, under the heading of "Deposits," the increase which has taken place in the volume of credit extended by the banks (national and state banks and trust companies) and, under the headings "Loans and Discounts" and "Investments," the operations against which the newly created credit was extended. The dates selected are: (1) the eve of our entry into the war; (2) the armistice; and, (3) the most recent date for which data are available:

Date	Gross Deposits	Loans and Discounts	Investments
(In millions of dollars)			
March, 1917	24,863	17,020	4,955
November 1, 1918	28,862	19,792	8,909
October, 1919	33,159	22,275	9,751

The above figures, which are partly official and partly estimated, show that, between March, 1917, and November 1, 1918, 3,999 millions of

new banking credit in the shape of so-called deposits were created—an increase of 16.1 per cent. Similar comparison for the item "Loans and Discounts" shows that between the same two dates there was an increase of 2,772 millions—an increase of 16.3 per cent; and that, for the item "Investments" for the same dates, there was an increase of 3,954 millions—or 79.8 per cent.

It will be noted that the most striking increase of percentage is found in the item "Investments" between the dates March, 1917, and November, 1918, when an increase of close to four billions of dollars is shown in the investment holdings of the banks. This was the period when the government's great bond-issuing operations were at their height: The banks were under pressure to make heavy investments of their credit in subscribing for government loans; they were also extending credit accommodation on liberal terms to their customers for the like purpose. This was also the period when the total currency in circulation was increasing most rapidly—the increase between March, 1917, and November, 1918, amounting to over one billion and a quarter.

But the expansion of banking credit did not come to a stop with the armistice. Figures given in the table above show that expansion has continued at an alarming rate since then. And the end is not yet assuredly in sight. Between the dates November 1, 1918, and October, 1919, 4,297 millions of dollars of new credit have been created; loans have increased 2,483 millions of dollars; and investments 842 millions of dollars.

It thus appears that for the whole period, March, 1917, to October, 1919, 8,296 millions of dollars of new banking credit have been created, most of which was undoubtedly occasioned by the exigencies of government financing.

It has recently been estimated (*Federal Reserve Bulletin* for October, 1919, page 942) that the banks of the country hold among their investments over four billions of dollars of government war securities (Liberty Bonds, Victory Notes or Certificates of Indebtedness) and, among their loans and discounts, two and a half billions or more representing loans made to customers secured by government obligations and made, presumably, for the most part, in aid of customers' subscriptions to government loans. Altogether then, it appears that the banks are carrying, directly or indirectly, between six and seven billions of government war obligations against which has been extended newly created credit in the form of deposits or currency.

Influence of Bank Credit on Prices.—This newly created credit, like the new currency, constitutes an addition to the supply of the country's purchasing media. It is for all practical purposes to be regarded as money. It is acceptable as a means of purchase and payment. It acts on prices substantially the same as money. It is the new and large addition to the country's circulating media, resulting from the placement of so large a portion of the Government's loans in the form of "credit loans"—that is, in excess of what the current savings of the people would support—that is largely responsible for that feature of our financial situation which has resulted in the continuing high prices, of which there is so much complaint.

The best way to improve our price situation is to improve our credit situation. Indeed, no great improvement in the price situation need be

looked for until the credit situation is materially improved. The banking and credit situation will improve as the large amount of war loan paper and investments now carried by the banks is liquidated. There is only one way to liquidate them and that is out of the proceeds of savings. Those who are debtor to the banks for credit accommodation in aid of subscriptions to government loans must be made to take up their obligations to the banks out of their individual savings, if it is at all possible for them to do so. If they can not do it, or, rather, to the extent that they can not do it, others must in effect do it for them; others must save and out of their savings buy Liberty Bonds in the market. Thus will the market for government bonds be improved and thus will it be made possible for the banks to liquidate by selling in the market bonds, which they have bought on credit, and their customers, the bonds which the banks are holding as collateral. Such liquidation will at once reduce the loan and investment accounts of the banks on the one side and their deposit liabilities on the other; and it will, in addition, bring a return flow of currency to the banks. It is thus that there will result from the process of saving, reduction in the volume of purchasing media and decline of prices.

Reduction of Inflation by Saving.—If everyone had done his full duty during the war by voluntarily rationing himself and saving to the requisite degree, most of the expansion of credit and currency and inflation of prices, from which we are suffering, would have been avoided. Because there were financial slackers who did not do their duty, expansion of credit and currency was carried to the point of inflation. The evils of inflation, of which the President warned the nation in his War Message of April 2, 1917, are now upon us in the shape of high cost of living, profiteering, speculation, reckless extravagance and industrial unrest and strife. These evils are to be reckoned as a part of the cost of the war. They are the cost of inflation. That cost must now be met. Until it is met, those evils will remain to plague us. Indeed, there is danger that they will grow worse through postponement or through national self-delusion that they can be escaped. Recent months have given dramatic evidence that the appetite for inflation, like most other appetites, grows by what it feeds upon. Inflation is breeding inflation. A halt must be called. Saving must again become the order of the day. We have too much credit and too much money outstanding in the United States—above all, too much unproductive credit. Its volume must be reduced. There is but one sure method: that is saving.